

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-03

INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03 SP-02

CIEP-01 LAB-04 SIL-01 OMB-01 PA-01 PRS-01 NSC-05

SS-15 STR-04 CEA-01 ABF-01 /083 W

----- 074603

R 101705Z MAR 76

FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC 9083

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POUCHED AS INFO TO ALL CONSULATES IN CANADA

E.O. 11652: N/A

TAGS: EFIN, CA

SUBJ: REACTION TO INCREASE IN BANK RATE

REF: A. OTTAWA 938; B. OTTAWA 965

1. INITIAL NEWSPAPER ACCOUNTS OF MAR 8 RISE IN BANK RATE STRESSED UNEXPECTEDNESS OF BANK OF CANADA ACTION (IN LIGHT OF CURRENT THREE TO FIVE PERCENT SPREAD BETWEEN U.S. AND CANADIAN INTEREST RATES), EXPECTED INCREASES IN CHARTERED BANKS' PRIME RATE, AND POSSIBILITY OF MORTGAGE RATES REACHING NEW HIGHS. BANK RATE INCREASE TO 9.5 PERCENT SETS RECORD WITH PREVIOUS HIGH ESTABLISHED IN JULY 1974 AT 9.25 PERCENT. IN JULY 1974 CHARTERED BANK PRIME RATE ROSE TO 11.5 PERCENT AND CONVENTIONAL MORTGAGE RATE WENT OVER 12 PERCENT LATER IN YEAR.

2. ON MAR 8 THREE CHARTERED BANKS -- ROYAL, BANK OF MONTREAL AND BANK OF B.C. -- INCREASED THEIR PRIME RATE TO 10:25 PERCENT. TORONTO AND MONTREAL STOCK EXCHANGES DROPPED ON SAME DAY, AND CANADIAN DOLLAR FOREIGN EXCHANGE LIMITED OFFICIAL USE

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RATE (VIS-A-VIS U.S. DOLLAR) ROSE SHARPLY. (NOON RATE

REPORTED BY BANK OF CANADA WAS US\$0.9850 EQUALS C\$1.00 AS  
OPPOSED TO MARCH 5 NOON RATE OF US\$0.9916 EQUALS C\$1.00.)  
RISE IN EXCHANGE RATE WAS PARTICULARLY STRONG SINCE  
BANK OF CANADA HAS TRIED IN PAST TO KEEP DAILY CHANGE  
IN RATE TO ABOUT \$0.0025.

3. TORONTO STAR OF MARCH 8 QUOTED DOUGLAS PETERS,  
CHIEF ECONOMIST FOR TORONTO DOMINION BANK, AS SAYING  
BANK OF CANADA MOVE INDICATED CANADA'S HIGH INTEREST  
RATES WILL CONTINUE FOR SOME TIME. "DON'T BE CRITICAL  
OF THE BANK OF CANADA", PETERS REPORTEDLY SAID, "THEY'VE  
BEEN LEFT WITH THE SOLE POLICY OF CONTROLLING INFLATION."  
MORE OMINOUS WAS PETERS' PREDICTION OF HIGHER UNEMPLOY-  
MENT AS A RESULT OF BANK OF CANADA ACTION.

4. CARL BEIGIE, EXECUTIVE DIRECTOR OF C.D. HOWE  
INSTITUTE, REPORTEDLY TOLD TORONTO STAR THAT RISE IN  
BANK RATE "SMELLS TO ME LIKE A TAX INCREASE IS COMING  
IN THE MAY BUDGET". HE IS QUOTED IN MONTREAL GAZETTE  
OF MARCH 9 AS SAYING HIGHER INTEREST RATES ARE RESULT  
OF STRUGGLE FOR AVAILABLE CREDIT AMONG CONSUMERS,  
BUSINESS AND GOVERNMENTS, AND SINCE OTTAWA APPEARS  
UNWILLING OR UNABLE TO CURB SPENDING, SOME CROWDING OUT  
IS INEVITABLE, WITH BUSINESS AND CONSUMERS LIKELY TO  
FEEL THE PINCH THE MOST.

5. GLOBE AND MAIL EDITORIAL OF MARCH 8 TOOK FEDERAL  
GOVERNMENT TO TASK FOR NOT PRACTICING FISCAL RESTRAINT  
SIMILAR TO MONETARY RESTRAINT IMPOSED BY BANK OF CANADA.  
HOWEVER, EDITORIAL POINTED OUT THAT BANK'S ACTIONS HAVE  
RESULTED IN OVERVALUED CANADIAN DOLLAR, "WHICH HAS NO  
RELATIONSHIP TO THE STRENGTH OF THE CANADIAN ECONOMY,  
WHICH IS A GOOD DEAL LESS STURDY THAN THE U.S. ECONOMY,  
AND IT IS UNFAIR TO CERTAIN INDUSTRIES AND REGIONS."

6. COMMENT: BANK OF CANADA MOVE TO EVEN HIGHER  
INTEREST RATES WILL PROBABLY RESULT IN SHORT-TERM UPWARD  
PRESSURE ON INFLATION RATES WITH HIGHER COSTS FOR BUSINESS  
EXPANSION, HOUSING AND CONSUMER DURABLE PURCHASES.  
(FIRA OFFICIAL, WHO WILL HAVE HIS HOME MORTGAGE "ROLLED  
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OVER" THIS SUMMER -- MOST MORTGAGES IN CANADA ARE RE-  
WRITTEN AFTER FIVE YEARS AT PREVAILING INTEREST RATES --  
TOLD EMBOFF HE WAS APPALLED AT HAVING HIS 8 PERCENT  
MOTGAGE BECOME 12 OR 13 PERCENT THIS SUMMER).

7. ALTHOUGH SOME OBSERVERS DOWNPLAY IMPORTANCE OF OVER-  
VALUED CANADIAN DOLLAR ON CANADIAN EXPORTS ON GROUNDS  
THAT BULK OF CANADIAN EXPORTS ARE COMMODITIES WHICH ARE

LARGELY UNAFFECTED BY CHANGES IN DOLLAR'S EXCHANGE VALUE, EMBASSY CONSIDERS THIS TO BE OVERLY SIMPLISTIC VIEW OF ECONOMY AND FINDS IT HARD TO SEE HOW OVERVALUED CANADIAN DOLLAR FOR ANY EXTENDED PERIOD OF TIME CAN AVOID HAVING ADVERSE EFFECTS -- POSSIBLY RATHER SERIOUS -- ON CURRENT ACCOUNT BALANCE. (SOME ANALYSTS HAD BEEN PREDICTING DROP IN C\$ FOREIGN EXCHANGE VALUE IN MID-1976 AS FOREIGN BORROWINGS OF PROVINCES AND MUNICIPALITIES LESSENER. NOW, HOWEVER, EXPECTED WIDENING OF SPREAD BETWEEN U.S. AND CANADIAN INTEREST RATES MAY SPUR ADDITIONAL CANADIAN BORROWINGS ABROAD AND ACT AS LURE FOR INCREASED FOREIGN FUNDS INFLOW).

8. SOME ANALYSTS ARE ALREADY EXPRESSING FEARS OF LONG-TERM CONSEQUENCES OF CURRENT HEAVY CANADIAN BORROWING ABROAD BY POINTING TO COSTS OF EVENTUAL REPAYMENT AND EFFECTS OF SUCH COSTS ON CANADA'S BALANCE OF PAYMENTS IN YEARS AHEAD. ITC ASST. DEP. MINISTER JEFF CHAMBERS TOLD EMBOFF ON MARCH 9 THAT LARGEST PERCENTAGE INCREASE IN 1975 CURRENT ACCOUNT DEFICIT CAME FROM SERVICE PAYMENTS, AND THAT FOREIGN BORROWINGS WOULD EXACERBATE SITUATION IN FUTURE. TO OVERCOME THIS DEFICIT, HE SAID, CANADA MUSST OBTAIN "EXTREMELY LARGE" MERCHANDISE TRADE SURPLUS, AND, IN HIS OPINION, FUNDAMENTAL CHANGES MAY BE NECESSARY IN CANADIAN TRADE POLICY. (HE DID NOT SPECIFY WHAT THOSE CHANGES WOULD ENTAIL).

9. THUS FAR, MOST PUBLIC CRITICISM HAS NOT CENTERED ON BANK OF CANADA'S DETERMINATION TO PURSUE MONETARY RESTRAINT BUT HAS BEEN DIRECTED AGAINST GOC FOR NOT PRACTICING SIMILAR FISCAL RESTRAINT. "EXCESSIVE" GOVERNMENT SPENDING IS RECURRENT THEME OF FINANCIAL COLUMNISTS AND BUSINESS LEADERS, AND RECENT BANK OF LIMITED OFFICIAL USE

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CANADA ACTION PROVIDED CRITICS WITH YET ANOTHER OPPORTUNITY TO CONTRAST GOC EXPECTED INCREASE OF 16 PERCENT IN FY 76/77 EXPENDITURES WITH BANK'S "TIGHT" MONEY POLICY.

10. EVEN WITHOUT BANK'S MOVE TO HIGHER INTEREST RATES, CONFERENCE BOARD AND OTHER SOURCES HAVE BEEN PREDICTING RISE IN UNEMPLOYMENT RATES IN NEXT SIX MONTHS WITH JOB OPENINGS FAILING TO KEEP PACE WITH GROWTH IN LABOR FORCE. WHAT ADVERSE EFFECTS HIGHER INTEREST RATES WILL HAVE ON BUSINESS EXPANSION AND ULTIMATELY ON UNEMPLOYMENT RATES IS DIFFICULT TO DETERMINE AT THIS TIME. CONFERENCE BOARD IN JANUARY QUARTERLY SURVEY OF CONSUMER CONFIDENCE REPORTED SHARP DROP IN CONSUMER SPENDING PLANS, AND WITH EVEN HIGHER INTEREST CHARGES

FOR HOUSING AND DURABLE PURCHASES AS RESULT OF BANK OF  
CANADA'S CURRENT ACTION, CONSUMER SPENDING PLANS MAY  
DECREASE EVEN FURTHER. THUS, ANALYSTS AND GOC OFFICIALS  
WHO HAVE BEEN PREDICTING REAL GNP GROWTH OF ABOUT  
5 PERCENT FOR 1976 MAY HAVE TO REVISE THAT FIGURE  
DOWNWARD. ENDERS

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## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** PRESS COMMENTS, PUBLIC ATTITUDES, BANK RATES, INTEREST RATES, FOREIGN EXCHANGE RATES  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 10 MAR 1976  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Authority:** BoyleJA  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1976OTTAWA00984  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** N/A  
**Errors:** N/A  
**Film Number:** D760091-0664  
**From:** OTTAWA  
**Handling Restrictions:** n/a  
**Image Path:**  
**ISecure:** 1  
**Legacy Key:** link1976/newtext/t19760376/aaaacomf.tel  
**Line Count:** 175  
**Locator:** TEXT ON-LINE, ON MICROFILM  
**Office:** ACTION EUR  
**Original Classification:** LIMITED OFFICIAL USE  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 4  
**Previous Channel Indicators:** n/a  
**Previous Classification:** LIMITED OFFICIAL USE  
**Previous Handling Restrictions:** n/a  
**Reference:** 76 OTTAWA 938, 76 OTTAWA 965  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** BoyleJA  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 12 APR 2004  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <12 APR 2004 by CunninFX>; APPROVED <02 AUG 2004 by BoyleJA>  
**Review Markings:**

Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
04 MAY 2006

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** REACTION TO INCREASE IN BANK RATE  
**TAGS:** EFIN, CA, BANK OF CANADA  
**To:** STATE  
**Type:** TE  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006